The American Consumer Institute
Center for Citizen Research

August 11, 2021

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve
20th Street and Constitution Ave.
Washington, DC 20551

Comments of American Consumer Institute Center for Citizen Research

RE: Proposed changes to Regulation II – Debit Card Interchange Fees and Routing (Docket No. R-1748, RIN 7100-AG15)

Dear Ms. Misback:

The American Consumer Institute Center for Citizen Research (ACI) respectfully submits comments on the Board of Governors of the Federal Reserve System's proposed revision to Regulation II (Debit Card Interchange Fees and Routing).

ACI is a 501(c)(3) non-partisan, educational, and public policy research organization with the mission to identify, analyze, and project the interests of consumers in selected legislative and rulemaking proceedings in matters that affect the consumers.

Under the proposed rule, "debit card issuers should enable, and merchants should be able to choose from, at least two unaffiliated networks for card-not-present transactions."[1] ACI is deeply concerned that the Federal Reserve's proposed rule to make changes to Regulation II would inflict significant harm on consumers and small businesses who depend on financial merchants and payment card networks to operate securely. We are particularly concerned that when cybersecurity is at the forefront of business operations and consumers' minds, the proposed rules could leave consumers vulnerable to fraud risks. We are also concerned that the proposed rule could further impede access to low-cost or no-cost financial services that would predominantly harm lower-income and minority Americans.

[1] "A Proposed Rule by the Federal Reserve System on 05/13/2021," *Federal Register*, https://www.federalregister.gov/documents/2021/05/13/2021-10013/debit-card-interchange-fees-and-routing.

Debit and Credit card payments have become an increasingly important part of the modern economy and financial ecosystem. In 2019, it has been estimated that there were 39.6 billion card transactions, equating to approximately 108.6 million transactions each day.[2]

To aid your understanding of our views, we have broken down our comments into the following sections:

I. Fraud prevention
II. Consumer welfare
III. Conclusion

I. Fraud prevention

The United States alone is responsible for more than a third of the total global loss, making it the most card fraud-prone country in the world. In 2019, the Federal Trade Commission (FTC) reported $1.9 billion of fraud losses in the United States and 1.7 million fraud reports.[3] Estimates at the end of 2020 show that the U.S. was seeing about $11 billion worth of losses due to credit card fraud.[4]

Given the significant problem fraud poses to consumers and businesses, credit card networks such as Visa, Mastercard, and American Express have invested significant amounts in fraud prevention and detection. For instance, since 2011, American Express has invested "in over 70 start-ups focused on commerce, payments, fraud prevention, data analytics, and security."[5] These investments have allowed American Express to create programs and analytical tools that enable it to "monitor in real-time and generate a fraud decision in milliseconds every single time an American Express card is used around the world."[6] As recently as April of 2021, Mastercard announced plans to acquire Ekata for $850 million to improve its fraud prevention efforts.[7]

We believe the proposed rule could expose the payments ecosystem to additional fraud and potentially reduce the overall level of security in the system, thereby creating additional risk for

---

[2] "The Average Number of Credit Card Transactions Per Day & Year," *Cardrates.com*, November 9, 2020, https://www.cardrates.com/advice/number-of-credit-card-transactions-per-day-year/#:~:text=If%20you%20divide%20that%20figure,in%20the%20U.S.%20every%20day.
[3] "Consumer Sentinel Network," *Federal Trade Commission*, January 2020. Available Online: https://www.ftc.gov/system/files/documents/reports/consumer-sentinel-network-data-book-2019/consumer_sentinel_network_data_book_2019.pdf.
[4] Nathaniel Lee, "Credit Card Fraud Will Increase Due to the Covid Pandemic, Experts Warn," *CNBC*, January 27, 2021, https://www.cnbc.com/2021/01/27/credit-card-fraud-is-on-the-rise-due-to-covid-pandemic.html.
[5] "About," American Express Ventures, https://www.americanexpress.com/us/business/american-express-ventures/about.html.
[6] "How Amex Protects You Against Credit Card Fraud," American Express, October 28, 2020, https://www.americanexpress.com/en-us/credit-cards/credit-intel/fraud-alerts/.
[7] Fionna Agomuoh, "Mastercard to Buy Ekata for $850M to Improve Fraud Detection," *The Street*, April 19, 2021, https://www.thestreet.com/investing/mastercard-buying-ekata-to-improve-fraud-detection.

consumers. Different networks and transaction types offer different protections against fraud, protecting consumers and minimizing fraud events. The proposal would make it difficult for financial institutions to manage how debit transactions are processed. Under the proposed rule, if applied to card–not-present transactions, retailers, not consumers, choose how transactions are routed.

More importantly, if a retailer chooses a debit network and transaction type that lacks security and necessary fraud mitigation benefits and fraud results, the merchant bears limited responsibility.[8]

Financial institutions that cover the losses and reverse fraudulent transactions for their consumers have the most incentive to ensure that their consumers are protected. Consumers have come to expect these security benefits as part of their financial institution's promise, but the proposed rule limits the ability of these institutions to choose the best debit networks to route transactions and best serve and protect their consumers.

II. Consumer welfare

Following the passage of the Durbin Amendment, banks and other financial institutions "reduced the availability of fee-free current accounts" consumers could enjoy. Zywicki, Manne, and Morris estimated that "the total number of banks offering free current accounts fell by 50% between 2009 and 2013." They also found that banks subjected to the Durbin Amendment "more than doubled the minimum monthly holding required on fee-free current accounts between 2009 and 2012, from around $250 to over $750."[9] Those who could not meet income thresholds faced maintenance fees that rose from around $2.00 in 2009 to $12.08 in 2012.[10] In total, it is estimated that nearly one million Americans, predominantly low-income and minority communities, lost access to free banking services as a result.

Faced with fewer free services and increased fees for financial services, millions of Americans have turned to alternative and black-market financial services that offer fewer protections and risk causing further financial instability.[11]

The provisions of expanding the routing requirement to all card–not–present transactions and the accompanying mandate that PINless transactions be accepted effectively creates a price-ceiling on the revenue financial institutions receive to participate in these transactions. In particular

---

[8] Dodd-Frank did not authorize processors to shift fraud liability to the issuer, but this is what is occurring under the proposed rule.

[9] Todd J. Zywicki, Geoffrey Manne, and Julian Morris, "Price Controls on Payment Card Interchange Fees: The U.S. Experience," *George Mason Law & Economics*, Research Paper No. 14-18, June 2, 2014, available at SRN: https://ssrn.com/abstract=2446080. or http://dx.doi.org/10.2139/ssrn.2446080.

[10] *Ibid.*

[11] Vassilisa Rubstova, "Banking and Poverty: Why the Poor Turn to Alternative Financial Services," *Berkley Economic Review*, April 15, 2019, https://econreview.berkeley.edu/banking-and-poverty-why-the-poor-turn-to-alternative-financial-services/.

community banks and smaller credit unions that currently do not support two networks for e-commerce transactions will see a significant drop in interchange revenue for those e-commerce transactions that are routed through EFT debit networks and not a global network as a result of the proposed rule.[12] Since 36% of debit card dollar volume is conducted through smaller financial institutions exempt from the regulation, there is a potential decrease in interchange fees for merchants or revenue for these smaller financial institutions on $82.5 billion in debit and prepaid debit purchases.[13]

Studies on the passage of the Durbin Amendment show that one of the most significant problems with the cap on interchange fees is that it denied consumers access to no-cost and low-cost financial services. Further regulation of interchange fees would only force banks and financial merchants to raise these fees further, denying more Americans the ability to access the financial system.

Additionally, the proposed rule does not take into consideration that the card market is a two-sided one where commercial interests of issuers must be balanced with the interests of merchants in order for consumers to enjoy fee-free services and other benefits. Instead, it follows the one-sided market model where network dynamics will be tilted towards merchants who will not directly bear the consequences of the cardholder experience being diminished.

Also concerning is that the proposed rule could drive further consolidation among the debit networks, reducing choice for issuers, small businesses, and consumers. No competitive analysis has been performed in support of the rule and to indicate the opposite.

Instead of imposing arbitrary mandates that only account for one part of the picture and completely overlook the effects on consumers, more effort should be placed on encouraging an environment in which networks compete on the quality of their network and offering consumers new options and services (e.g. faster secured payments systems).

III. Conclusion

In light of the issues discussed above, it is the view of ACI that the Federal Reserve's proposal regarding Regulation II would inflict significant and unnecessary harm onto the current ecosystem and American consumers. The proposed rule risks not only making consumers more vulnerable to fraud, but also risks changing the current ecosystem by creating a price-ceiling on the revenue financial institutions receive, which would disproportionately affect community banks and smaller credit unions, and prevent low-income and minority communities from accessing safe and secure banking services.

---

[12] Sarah Grotta, "Will the Fed Clarify Regulation II to Enforce Utilization of Two Unaffiliated Networks?" Mercator Advisory Group, June 10, 2021, https://www.mercatoradvisorygroup.com/Viewpoints/Will_The_Fed_Clarify_Regulation_II_to_Enforce_Utilization_of_Two_Unaffiliated_Networks___Mercator_Sees_it_as_Likely/.

[13] *Ibid*.

As such, it is questionable how and whether the proposed rule actually helps consumers since it does NOT address the protection of consumers' debit card purchases, nor does it lead to an improved consumer experience or a more secure payment system.

Respectfully Submitted,

Krisztina Pusok, Ph.D.
Director
American Consumer Institute Center for Citizen Research
1701 Pennsylvania Ave. NW, Suite 200
Washington, DC 20006

Edward J. Longe
Policy Manager
American Consumer Institute Center for Citizen Research
1701 Pennsylvania Ave. NW, Suite 200
Washington, DC 20006